

**Letter of Findings Number: 04-20110374**  
**Use Tax**  
**For Tax Year 2010**

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**ISSUES**

**I. Use Tax–Like Kind Exchange.**

**Authority:** IC § 6-2.5-1-6; IC § 6-2.5-3-2; IC § 6-8.1-5-1; [45 IAC 2.2-1-1](#); [45 IAC 2.2-3-4](#).

Taxpayer protests the imposition of use tax based on the like kind exchange exemption.

**II. Tax Administration–Fraud Penalty.**

**Authority:** IC § 6-8.1-10-4; [45 IAC 15-5-7](#); [45 IAC 15-11-2](#); [45 IAC 15-11-4](#).

Taxpayer protests the imposition of a one hundred percent fraud penalty.

**STATEMENT OF FACTS**

Taxpayer is an individual resident of Indiana. In 2010, Taxpayer registered a motorcycle with the Indiana Bureau of Motor Vehicles ("BMV") and paid sales tax on the reported purchase price of one hundred dollars (\$100). As part of an audit, the Indiana Department of Revenue ("Department") sent questionnaires to the two individuals listed as sellers of the motorcycle. Those questionnaires were returned with the information that the selling price of the motorcycle purchased by Taxpayer was \$13,500. The Department therefore determined that Taxpayer had not paid sales tax on the total purchase price of the motorcycle and issued proposed assessments for use tax on the remaining \$13,400 of the selling price as reported by the sellers, along with interest and a one hundred percent fraud penalty. Taxpayer protests the imposition of use tax, interest and penalty. An administrative hearing was held and additional time was allowed for the submission of additional documentation in support of Taxpayer's protest. Taxpayer was unable to produce any additional documentation, but was able to provide additional analysis and explanation. All submitted information was considered and this Letter of Findings results. Further facts will be supplied as required.

**I. Use Tax–Like Kind Exchange.**

**DISCUSSION**

Taxpayer protests that he exchanged various pieces of tangible personal property, such as two car engines, fiberglass racing seats, tires, and other automotive parts, to the sellers along with the \$100 which was reported to the BMV. Taxpayer believes that this barter should result in no sales or use tax due. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessments are made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

- (a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer had not paid sales tax on some taxable purchases and so imposed Indiana use tax on those purchases.

Also of relevance is IC § 6-2.5-1-6, which provides:

- (a) "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:
  - (1) the property exchanged is of the same kind or character, regardless of grade or quality; and
  - (2) the persons exchanging the property both own the property prior to the exchange.
- (b) A "like kind exchange" may be a part of a transaction involving additional consideration other than the exchanged property.

(c) Notwithstanding subsection (a), a "like kind exchange" does not occur when:

- (1) the transaction involves more than two (2) persons; or
- (2) one (1) party to the transaction, through agreement or negotiation with the second party, acquires personal property for the primary purpose of exchanging that property for like kind property held by the second party.

(Emphasis added).

[45 IAC 2.2-1-1](#) states in relevant parts:

...

(k) Like Kind Exchange: Limited to Two Parties. Non-taxable "exchanges" include only transactions for a swap or barter of property between two parties. Property received in an exchange transaction in which a third party is involved, with or without property, is subject to gross retail tax. This rule is not meant to deny non-taxability of exchanges where one or both of the parties in a two-party exchange employ an agent in carrying out the agreement.

(l) Like Kind Exchange: Property to be Owned by Parties at Time of Exchange. Non-taxable "exchanges" include only transactions in which the property exchanged is owned by the parties thereto at the time the exchange agreement is entered into. Transactions in which the property to be exchanged is acquired by one party after the agreement to exchange has been arranged are taxable. The exchange agreement must specify the definite units or quantity of property to be exchanged. However, "retail merchants" are allowed to consider as non-taxable the full value of tangible personal property of like kind received in allowable exchanges, even though ownership of the property received is encumbered by a conditional sales contract, retail installment contract, or a chattel mortgage.

....

(Emphasis added).

Therefore, the "barter" to which Taxpayer refers is also known as a "like kind exchange," as provided by [45 IAC 2.2-1-1](#)(k). Also, the property exchanged must be of the same kind or character in order to be considered part of a non-taxable sale, as required by IC § 6-2.5-1-6(a)(1). Additionally, such an exchange must be between only two parties, as described in [45 IAC 2.2-1-1](#)(k). Finally, such an exchange must have an exchange agreement which specifies the definite units to be exchanged, as required by [45 IAC 2.2-1-1](#)(l).

In this case, Taxpayer exchanged non-motorcycle parts for a motorcycle. This does not qualify for the like kind exchange exemption found in IC § 6-2.5-1-6. Also, the motorcycle had two different individuals listed as owners. Thus, the sale does not qualify for the like kind exchange exemption, as provided by [45 IAC 2.2-1-1](#)(k). Finally, Taxpayer did not provide any exchange agreement which specified the definite units to be exchanged. Therefore, the exchange does not qualify as a like kind exchange under [45 IAC 2.2-1-1](#)(l). Taxpayer has not met the burden of proving the proposed assessment of use tax wrong, as required by IC § 6-8.1-5-1(c).

#### FINDING

Taxpayer's protest is denied.

#### II. Tax Administration—Fraud Penalty.

#### DISCUSSION

Taxpayer protests the imposition of one hundred percent fraud penalty and interest. The Department is prohibited from waiving interest, as provided by IC § 6-8.1-10-1(e). Taxpayer states that the penalty will cause an extreme financial burden and that he did not intentionally misstate the value of the motorcycle.

The Department refers to IC § 6-8.1-10-4, which states:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100[percent]) multiplied by:
  - (1) the full amount of the tax, if the person failed to file a return; or
  - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of the tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department or fails to pay the tax due under [IC 6-6-5](#), [IC 6-6-5.1](#), or [IC 6-6-5.5](#) commits a Class A misdemeanor.
- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2.1 of this chapter.

(Emphasis added).

Next, the Department refers to [45 IAC 15-11-4](#), which states:

The penalty for failure to file a return or to make full payment with that return with the fraudulent intent of evading the tax is one hundred percent (100[percent]) of the tax owing. Fraudulent intent encompasses the making of a misrepresentation of a material fact (See [45 IAC 15-5-7](#)(f)(3)) which is known (See [45 IAC 15-5-7](#)(f)(3)(B)) to be false, or believed not to be true, in order to evade taxes. Negligence, whether slight or great, is not equivalent to the intent required. An act is fraudulent if it is an actual, intentional wrongdoing, and the intent required is the specific purpose of evading tax believed to be owing.

Also, [45 IAC 15-5-7](#) provides in relevant part:

(f) The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision. Also, a substantially blank, unsigned or fraudulent return will not start the running of the statute of limitations.

(1) A substantially blank return is one which does not furnish all the information necessary to determine a taxpayer's liability for the tax in question. In order for a return to be complete enough to determine the taxpayer's liability, the information does not have to be correct. Any denotation by the taxpayer which clearly indicates a positive denial of liability for any tax listed on the tax form shall constitute a completed return. Thus, a return which has "zero," or "-0-" or "none" written on a given line is not substantially blank. Also, if a taxpayer makes a positive indication of liability on a line which constitutes a total of one or more taxes, a return is deemed to be completed for all such taxes even if the particular line for the tax(es) is left blank.

(2) An unsigned return is one which does not have the original hand written signature of the individual taxpayer or corporate officer or their authorized designee. The return also must be dated.

(3) A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.

(A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

(B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.

(C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

(D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

(E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present.

This must be shown by clear and convincing evidence.

(Emphasis added).

Finally, [45 IAC 15-11-2\(b\)](#) provides:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

In this case, Taxpayer has provided sufficient explanation and documentation to establish that he did not meet all five criteria listed in [45 IAC 15-5-7\(f\)\(3\)](#). Therefore, the one hundred percent fraud penalty will be waived. As previously explained, the Department may not waive interest.

#### **FINDING**

Taxpayer's protest is sustained regarding the fraud penalty. Taxpayer's protest is denied regarding interest.

#### **SUMMARY**

Taxpayer's protest is denied regarding the imposition of use tax. Taxpayer's protest is sustained regarding the imposition of the fraud penalty. Taxpayer's protest is denied regarding the imposition of interest.

*Posted: 01/25/2012 by Legislative Services Agency*

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